THE MANITOBA TELEPHONE SYSTEM

1989 Annual Report

91-01450/

MTS MISSION

To meet the telecommunications needs of all Manitobans with the right solutions, outstanding service, and superior products.

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ANNUAL REPORT

FOR THE 12 MONTHS ENDED DECEMBER 31, 1989

MANITOBA TELEPHONE SYSTEM
Tom Stefanson
Chairman
Box 6666, 489 Empress Street
Winnipeg, Manitoba
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Envoy: MTS.CHAIR

April 27, 1990

Honourable Glen Findlay
Minister Responsible for
The Manitoba Telephone Act
Legislative Building
Winnipeg, Manitoba
R3C 0V8

Dear Sir:

I have the honour of presenting the Annual Report of the Manitoba Telephone System together with financial statements for the fiscal year ended December 31, 1989.

Respectfully submitted

Tom Stefanson
Chairman of the Board

MANITOBA TELEPHONE SYSTEM

With you all the way!

BOARD OF COMMISSIONERS

(Left to right) Edgar Penner; Helmut Pankratz, MLA (seated); Rubin Spletzer; Tom Stefanson, Chairman; Holly Beard; Patricia Graham, Vice-Chairman; Roy McMillan; Joanne Swayze; Sam Schellenberg.

EXECUTIVE OFFICERS

Reg Bird
President & C.E.O.

Dennis Wardrop
Executive
Vice-President

Bill Fraser
Vice-President
Finance

John Milne
Vice-President
Corporate Services

Denis Sutton
Vice-President
Human Resources

Brian McCallum
Vice-President
Customer Services

Roger Ballance
Vice-President
Business Communications

Barry Deakin
Vice-President
Diversified Operations

Barry Gordon
Vice-President
Network Services

Doug Delgatty
Vice-President
Western Region

Gordon Holman
Vice-President
Northern Region

Ed Tinkler
Vice-President
Eastern Region

1989 HIGHLIGHTS

Operational

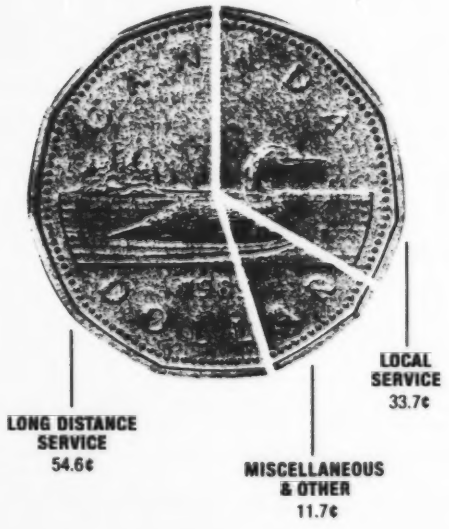
- The number of main stations (telephones) in service increased to 536,214, an increase of 1,395.
- On average, MTS handled 5,976,000 local calls and 319,000 long distance calls daily, increases of 3.4% and 10.8% respectively over 1988 average daily calling volumes.
- Twenty-three exchanges in rural Manitoba and two in Winnipeg were converted to digital switching technology.
- The $233 million Individual Line Service program to eliminate multi-party service throughout the province was officially launched on November 2, 1989.
- The MTS Special Needs Centre opened in June, 1989 to help people with vision, hearing and motion disabilities select specialized telecommunications equipment to access the MTS network.
- MTS Cellular's service area expanded to encompass more than 89% of the province's population.
- Sixty-seven communities, representing over 82% of Manitoba households, now have access to cable television service through MTS-supplied facilities.

Financial Highlights—1989

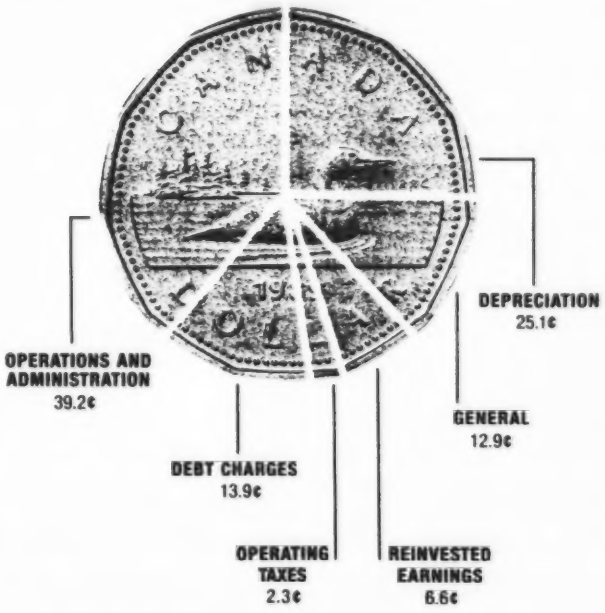
Value of telephone plant	$1,593,364,000
Operating revenues	516,564,000
Operating expenses	428,804,000
Net earnings for the year	35,644,000

THE MTS DOLLAR—1989

Where each dollar came from:



Where each dollar went:



CHAIRMAN'S REPORT

I am pleased to be submitting my first report as Chairman of the Manitoba Telephone System for a year in which the Corporation achieved significant results. It was a year in which we achieved solid financial gains, long distance rate reductions and important accomplishments in our service programs and initiatives.

On September 29, 1988, the Honourable Glen Findlay, Minister responsible for the Manitoba Telephone System, unveiled a bold, multi-year $800 million program to provide Manitobans, regardless of where they live, a new standard of telephone service. That program has served as the focal point of the Corporation's operational and customer service achievements during this year under review.

It is a measure of the Corporation's commitment to this program that the first customers to be converted under the Individual Line Service program were transferred from multi-party to individual line service in November, 1989, in advance of the original conversion schedule. In addition, a substantial number of digital switches were installed in central offices throughout the province and the Special Needs Centre providing specialized telecommunications products and services for handicapped people was opened. The Financial statements contained in this Report show net earnings for 1989 of $35,644,000 and a reduced debt/equity ratio. The most significant factor contributing to this performance was the Corporation's increased long distance revenues.

The impressive revenue increases achieved during 1989 reflect a strong demand for telecommunications products and services. MTS has a strong commitment to service and financial accountability and this is very much in keeping with the Corporate Mission and Goals established by the Board in 1988 and re-affirmed in December, 1989.

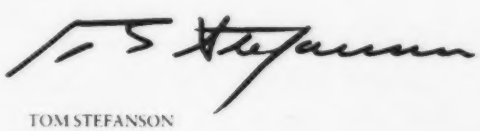
With the advent of greater competition within the telecommunications industry, significant policy and regulatory changes can be expected. Some of these came to the fore during 1989 in discussions relating to federal jurisdiction over provincially-operated telephone companies; others will undoubtedly emerge in the future. Regardless of the outcome of these on-going discussions, the System's 1989 performance indicates MTS has the resources, experience and commitment to respond to whatever challenges this changing industry faces in the future.

During the year under review, Board members participated in public meetings throughout the province. These meetings provided opportunities to meet informally with customers to discuss their concerns and expectations. Those discussions underlined the need for expanded toll-free programs such as the Community Calling Plus the Urban Unlimited proposals which were filed with the Public Utilities Board on October 31, 1989.

With the arrival of the 1990s, the Manitoba Telephone system enters the most challenging decade in its history. The telecommunications industry is experiencing a period of rapid technological advancement. At the same time, the environment in which it operates is changing rapidly. The most important challenge facing the Corporation is to examine and re-define the company's strategic direction.

Prudent financial management will also be essential during the 1990s and the Board of Commissioners has made that a top priority. Based on past performance, I am confident all MTS employees will continue to reflect a spirit of commitment, determination and optimism as we work towards meeting the challenges of the new decade.

On behalf of the MTS Board and personally, I thank all of our 5,462 employees for their support during the year. Their contributions made 1989 a landmark year and their cooperation and dedication will continue to be MTS's greatest strength in the future.



TOM STEFANSON
CHAIRMAN

PRESIDENT'S REPORT

The year 1989 was one of achievement, both in terms of pursuing our Corporate Mission—"To meet the telecommunications needs of all Manitobans with the right solutions, outstanding service and superior products" and achieving our goal "to be financially responsible and self sufficient." MTS attained strong financial performance—the best in its history—and is positioned to capitalize on opportunities in the 1990's.

The Financial Statements contained in this report are encouraging evidence that improved service and improved financial performance can go hand in hand. In 1989, the company achieved total operating revenues of $516,564,000 and net earnings rose to $35,644,000. These net earnings levels are particularly encouraging since they were achieved along with significant long distance rate reductions implemented during the year.

Our focus in 1989 was "Service for the Future," a five-year, nearly-$800-million service improvement program to bring state-of-the-art telecommunications to all Manitobans. With telecommunications playing an increasingly important role in people's lives and in the country's prosperity, it is vital that MTS maintain a network capable of sustaining current demand, while evolving toward meeting the more advanced technological demands of the 1990's and beyond.

In 1989, three "Service for the Future" initiatives underlined our commitment to superior service: an accelerated digital conversion program, the Individual Line Service (ILS) program to eliminate multi-party service and Community Calling.

During the year, 25 exchanges were converted to digital switching technology to provide new reliability, transmission quality and access to a host of optional calling convenience features including call waiting, speed calling and call forwarding. This program will be supported with the signing of a $166 million contract with Northern Telecom for the supply of digital switching equipment for the duration of the program. The contract will enable MTS to meet or accelerate our modernization program and achieve significant savings at the same time.

Inauguration of the ILS program was marked with a ceremony in Darlingford, Manitoba on November 2, commemorating the first transfer from multi-party to individual line service. When the program is completed by the mid-1990's, all Manitoba customers, regardless of where they live, will enjoy the convenience and privacy of an individual telephone line. Party lines will have been eliminated.

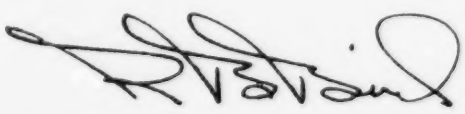
In response to a request from The Public Utilities Board of Manitoba (PUB), MTS re-examined the province-wide Community Calling program included in the original "Service for the Future" plan. In October, MTS filed with the PUB two innovative plans, Community Calling Plus and Urban Unlimited. Unique in Canada, these plans will reduce from 160 to 60 the toll free calling zones in Manitoba and will eliminate toll charges between many adjacent rural communities. A decision on these plans is expected early in 1990. This ambitious program is the first of its kind undertaken by a telephone company in North America.

To prepare MTS for future challenges, the company was reorganized into a number of Strategic Business Units (SBU's) to provide greater management flexibility and accountability, plus a more effective structure for serving our customers. These SBU's, complemented with comprehensive staff training and development programs, will help prepare MTS for the challenges and opportunities of what will undoubtedly be an increasingly deregulated and competitive marketplace.

The skills, talents and dedication of the men and women employed within MTS are the key to our success and to our future competitive position. I want to congratulate them for their contribution to the strong performance of the company this year.

On behalf of the MTS, I want to thank the Honourable Glen Findlay, Minister responsible for The Manitoba Telephone Act, Tom Stefanson, Chairman of the Board of Commissioners and the Commissioners for their support and cooperation.

I am confident that MTS is ready to realize the solid opportunities before it and will continue to play a major role in the development and provision of telecommunication services to Manitobans in the coming decade.



REG BIRD
PRESIDENT AND CHIEF EXECUTIVE OFFICER

FINANCIAL SUMMARY

Net earnings for the year ending December 31, 1989, were $35,644,000 compared to $15,445,000 for the previous year.

Revenues from all sources amounted to $539,266,000, an increase of $65,432,000 over last year. Long distance service provided 54.6% of the Company's revenues and at $294,453,000 was up $40,712,000 over 1988. Sixty-eight percent of long distance revenues were derived from calls made to points outside Manitoba and undertaken in conjunction with other member companies of Telecom Canada.

Revenues from local telephone service increased by $15,485,000 to reach $181,534,000. Miscellaneous revenues increased $5,802,000. Other revenues, attributed to higher interest income, totalled $22,702,000, an increase of $3,433,000 from the previous year.

New telecommunications property added during the year amounted to $174,056,000, an increase of $14,128,000 over the previous year. Total property values as at December 31, 1989, were $1,593,364,000. This represents an average investment in plant per main telephone of $2,972.

Depreciation of telecommunications property totalled $135,181,000, an increase of $16,546,000 compared to the previous year. Operations and administration costs amounted to $211,135,000, an increase of $22,867,000. Total operating expenses increased by $48,031,000 to $428,804,000.

Debt charges were $74,818,000, down $2,798,000 from 1988. The decrease is due mainly to a decrease of $2,163,000 in unrealized and realized foreign currency losses resulting from improved foreign exchange rates at December 31, 1989.

Long term debt amounted to $771,197,000, a decrease of $5,749,000 from 1988. Debt retirements during the year were $118,000 with $35,000 of the repayment being provided by the Sinking Fund. Contributions to the Sinking Fund of $10,115,000 were made as required under The Manitoba Telephone Act. During the year, the Board of Commissioners approved an increase in investments held for pension obligations of $37,422,000.

Reinvested earnings totalled $122,999,000 at December 31, 1989, which was increased by the net earnings for the year of $35,644,000.

OPERATIONAL REVIEW

Manitoba Telephone System's performance during 1989 was characterized by record net earnings and impressive increases in long distance calling volumes. At year end, a total of 536,214 main stations were in place, an increase of 1,395 over 1988.

MTS's 1989 financial performance established an all-time record. Net earnings were $35,644,000 on total operating revenues of $516,564,000 and operating expenses of $428,804,000. This represents an increase of approximately 131% in net earnings over the previous year.

A major factor in the improved performance was strong demand for long distance services which contributed $294,453,000, or 54.6% of total revenues. Long distance calling volumes, encouraged by reductions of 12.8% in interprovincial long distance rates approved by the Public Utilities Board, increased nearly 10% over the previous year. During 1989, the company handled a total of 115,984,000 long distance calls. Our operators handled almost 12 million of these calls.

The improved net earning entitled MTS to a larger share of the inter-provincial long distance revenues under the terms of Telecom Canada's Revenue Sharing Plan. Net revenue is one of the factors considered in determining the member telephone company's share of these revenues.

"SERVICE FOR THE FUTURE" UNDERLINES CUSTOMER SERVICE COMMITMENT

In 1988, the Government of Manitoba announced a nearly-$800-million program to upgrade all exchanges in Manitoba to digital technology and to provide individual line service to all Manitobans by 1996. Included in the "Service for the Future" program were plans to reduce the number of toll-free calling areas in Manitoba and to provide improved service to customers with speech, hearing, vision or motion disabilities.

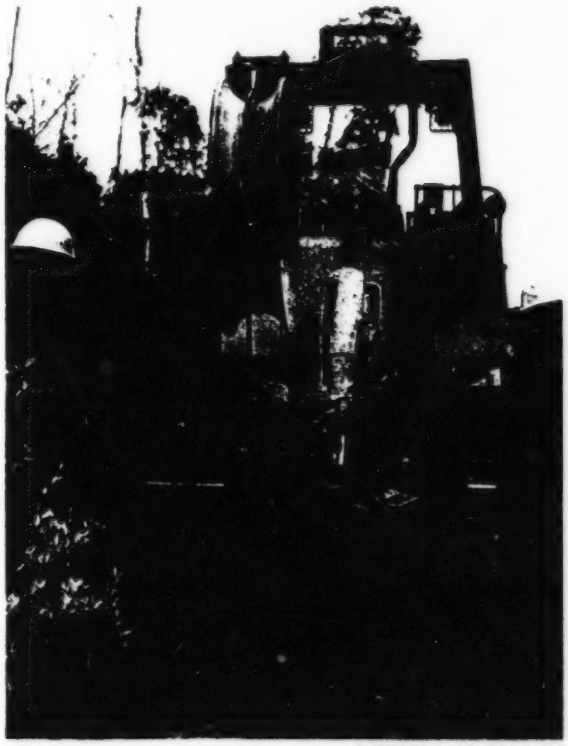
This program is the Government of Manitoba's response to demands from rural customers for improved telephone service and greater access to the full range of telecommunications products and services now available in the larger urban areas.

DIGITALIZATION PROGRAM SCHEDULED FOR MID-1990'S COMPLETION

During the year, telephone service to individual homes and businesses was introduced to two northern communities previously served only by paystations—Lac Brochet and Tadoule Lake. Two hundred people in these remote communities can now take advantage of a full range of optional calling features. These were the last remaining communities in Manitoba to be converted from community payphone service to individual lines.

At the same time, 23 exchanges in rural communities and two in Winnipeg were upgraded to digital technology as part of MTS's program to establish an all-digital switched network by the mid-1990's. Digital switching offers significant speed and reliability benefits, access to custom calling services including call forwarding, call waiting, speed calling, and computer link-up.

On November 2, 1989, the $233-million Individual Line Service program was officially inaugurated at Darlingford, Manitoba, at a ceremony marking the first conversion to individual line service. Shortly thereafter, two more exchanges, Beulah with 114 multi-party customers, and Bowsman with 245 multi-party customers, were converted to individual line service. In communities just outside the City of Winnipeg, 58 customers were upgraded to individual lines by November 17, 1989. The remaining 361 multi-party lines now served by Winnipeg wire centres will be converted to private line service in 1990.



PHOTOGRAPHY – RICHARD PULLANO

The $233 million Individual Line Service (ILS) program is a major component of "Service for the Future" and is dedicated to providing all customers with the privacy and convenience of individual line service by 1996, regardless of where they live.

During 1989, MTS construction crews were busy throughout the province installing and upgrading the network to support the ILS program and to provide facilities to accommodate rural growth and demand for premium services.

MTS PROPOSES EXPANDED COMMUNITY CALLING PROGRAMS

On March 31, 1989, in its approval of the "Service for the Future" proposal, the Public Utilities Board of Manitoba asked MTS to review the Community Calling portion of the "Service for the Future" proposal.

In October, 1989, MTS filed with the Public Utilities Board two revised toll-saving plans—Community Calling Plus and Urban Unlimited. In addition to reducing the number of toll-free calling areas from 160 to 60, Community Calling Plus added two-way toll free calling between adjacent exchanges, with the exception of Winnipeg and Brandon. An optional program providing toll free access to Winnipeg and Brandon from adjacent exchanges, Urban Unlimited, was introduced for a flat monthly fee. These plans providing for toll free calling between adjacent exchanges are the first of their kind to be offered in Canada.

Drive-up payphones, a service which seemed to be going the way of drive-in movies and hamburger stands into oblivion, made a comeback in Manitoba during 1989 as customers recognized the security and convenience of calling from their cars.

These distinctive MTS-designed units, strategically and conspicuously located in high-traffic areas or isolated locations when emergency communication could be vital, offer 24-hour access for the travelling public plus convenience and peace of mind.

MEETING THE NEEDS OF MANITOBANS WITH DISABILITIES

The MTS Special Needs Centre, officially opened in June, 1989, was another "Service for the Future" initiative which outlines MTS's commitment to superior service for all Manitobans. The Centre, conveniently located in downtown Winnipeg, is staffed by people especially trained to recommend specialized telecommunication equipment and services to customers with hearing, speech, vision or motion disabilities.

To complement the Special Needs Centre's activities, the company filed an application with the Public Utilities Board requesting permission to provide customers with disabilities main telephone sets and any accessories they may need to use the equipment at the basic rotary dial or Touch Tone monthly rate. The application also recommended outright sales, at cost, of non-lease equipment to customers with disabilities. The application was approved and the new rate structure will take effect January 1, 1990.

PUBLIC TELEPHONE IMPROVES ACCESSIBILITY

In 1989, the 100th anniversary of the public telephone, MTS established its Public Telephone Services as a Strategic Business Unit. Customer convenience was the goal of several projects undertaken during the year by MTS's Public Telephone Service. In November, the 6,000th payphone was installed, part of a three-year program to significantly increase the ease of access to public telephones throughout Manitoba. This expansion program also involved reassessing payphone locations, improved signage and the introduction of a new drive-up payphone design enabling customers to call from the comfort and safety of their vehicles.

The opening of the MTS Special Needs Centre in downtown Winnipeg in June, 1989, was a major step in fulfilling a "Service for the Future" commitment to help meet the communications needs of customers with hearing, speech, vision or motion disabilities.

The new Centre handles an average of 350 to 400 telephone enquiries and 85 to 100 customer visits per month. Centre staff also made 15 in-home customer visits to people in Winnipeg and outlying communities who, because of distance or disability, were unable to come to the Centre.

MEETING THE CHALLENGES OF COMPETITION

During 1989, MTS's Business Communications Group continued to focus on the challenges of an increasingly competitive market for non-regulated products and services. At the same time, strategies were developed positioning MTS to compete aggressively should the market move towards a more competitive environment for business terminal equipment and private lines.

Our customers signed a large number of extended rental agreements which guaranteed rates for a longer term rental commitment. Strategic alliances with major equipment suppliers were formed to provide customers with a selection of terminal equipment options. MTS successfully marketed Centrex service to a variety of small- to medium-sized firms and customers with more than one location.

Other significant Business Communications achievements included provision of Mitel SX-50 and SX-200 systems for the province-wide Country Hospitality Inn chain. In cooperation with the Manitoba Health Services Commission in their effort to automate services in the health industry, a joint major sale with UNISYS Inc. for data communications services and products was made to approximately 40 hospitals and personal care homes. A contract for internal communications wiring in the new Toronto Dominion Centre at Portage and Main was finalized. The Cadham Provincial Laboratory was equipped with province-wide Envoy 100™ and an iNet-based™ diagnostic reporting network.

MTS Phone Centres in communities throughout the province offered customers a variety of personalized services including opportunities to choose from a wide selection of telephone models, informed advice on MTS products and services, prompt and efficient repair services and in-person bill payment.

During 1989, the Downtown Winnipeg Phone Centre, designed to reflect a "new look" in Phone Centre retailing, was relocated to the Shops of Winnipeg Square to provide improved customer access and convenience.

SERVICE AREA EXPANSION HIGHLIGHTS MTS CELLULAR'S SECOND YEAR

During 1989, its second year of operation, MTS Cellular continued to exceed market projections. The major emphasis focused on expanding the service coverage area and development of a professional, responsive independent dealer network throughout its service area.

MTS Cellular now provides uninterrupted service in Winnipeg and Brandon and along a Trans-Canada Highway corridor from the Lake of the Woods to beyond the Saskatchewan border. New cell sites at Kenora, Ontario, Belair and Lac du Bonnet extended coverage to the cottage communities on Lake Winnipeg, in the Whiteshell and in the Lake of the Woods area. By the end of 1989, MTS Cellular service was available to more than 89% of the province's population.

BROADCAST INDUSTRY GROUP

For MTS's Broadcast Industry Group, 1989 saw renewal of a five-year contract between Telecom Canada and CBC Radio valued at $31.0 million and a nine-year $85 million contract with CBC Television. Telecom Canada member companies, including MTS, will share these revenues under the provisions of the Telecom Canada Revenue Sharing Plan.

The Broadcast Group was also involved in two important service expansion programs. In July, MTS initiated delivery of CBC Radio programming to the North via satellite, a technology that improves the reliability and quality of Northern Radio Services. Also, CATV services were extended to Snow Lake, the 67th Manitoba community to use MTS's Local Broadband Network.

On January 26, 1989, the Provincial Government implemented a policy change to allow cable television companies to develop their own distribution systems utilizing MTS's poles, towers or cable trenches where practical. Cable TV operators serving about 62 smaller communities in the province have applied to develop their own systems under the new policy. At year end, over 82% of Manitoba's households had access to MTS-supplied cable television facilities.

In 1989, MTS initiated an extensive corporate identification review to develop contemporary designs and concepts which would reflect its new customer service orientation.

New "business dress" for all MTS employees who have personal contact with customers was developed by Sheila Newbatt (centre). Combined with employee identification cards, the uniforms will mean customers can quickly and easily identify MTS employees.

APPOINTMENTS TO BOARD OF COMMISSIONERS AND MTS ORGANIZATION

On August 18, 1989, The Honourable Glen Findlay, Minister responsible for The Manitoba Telephone System appointed Tom Stefanson, C.A. as Chairman of the Board of Commissioners replacing Professor Paul Thomas. To fill the MTS Board of Commissioner's vacancy left by Mr. Stefanson's appointment, the Minister appointed Mr. Sam Schellenberg, an Emerson farmer and businessman, to the Board.

"These appointments," the Minister said, "will enhance MTS's ability to respond to the challenges ahead while continuing to meet its traditional public service obligations to rural Manitoba."

Effective July 1, the Board of Commissioners approved organization changes resulting from the creation of decentralized customer-specific business units. Dennis McCaffrey assumed the position of Director, Marketing, John Fritz, General Manager, Operations of the Business Communications SBU and Cliff Durston was appointed Director, Corporate Information Systems, Corporate Services. On September 1, Gordon Holman became Vice President, Northern Region. Throughout 1989, the following appointments were also made: Ian Ross, General Manager, Public Telephone Service; Glen Treffry, General Manager, Southwest Area, Western Region; Ted Scoles, General Manager, Broadcast Communications; Louise Soni, Acting General Manager, Operator Services; Roy Sherbo, General Manager, Business Networks; Kathy Desautels, Executive Assistant to the President; Jack Hawthorne, General Manager, Steinbach Area, Eastern Region; and Marilyn Edwards, General Manager, Brandon Area,Western Region.

DEVELOPING HUMAN RESOURCES TO MEET FUTURE CHALLENGES

During the year, MTS commissioned an extensive survey to determine employee attitudes towards the corporation's re-positioning from a "cost containment orientation" to a more focused "customer service orientation." The survey, conducted by the Angus Reid Group, indicated a need for adjustment in employee perceptions of MTS's image. Employees tended to underestimate to a considerable extent the degree of satisfaction expressed by residential and small business customers while overestimating the level of satisfaction expressed by key account customers during an earlier survey. Just under 50% of all MTS employees identified customer satisfaction as their primary job priority; one quarter said they were most concerned about the quality and accuracy of their work; and 11% said they were most concerned with productivity or efficiency. At the same time, more than three-quarters of employees indicated positive job satisfaction levels. However, employees indicated the need for improvement in providing equal opportunities and a suitable environment to develop employee competence, commitment and satisfaction.

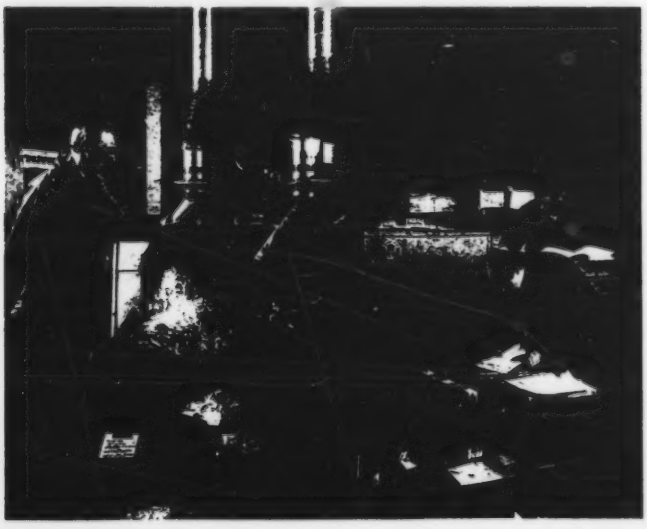
During the year, MTS Human Resources addressed that concern with a number of programs. Comprehensive training programs ranged from orientation sessions for new employees to over 300 different in-house programs involving 25,500 training days. These were complemented by corporate award plans which recognized outstanding achievements in various areas including sales, safe driving, and customer services.

Recruitment and selection programs included scholarship programs for target group students entering disciplines pertinent to MTS and operator training programs targeted for visible minority groups. A three-year $30,000 commitment was also made to the Canadian Council on Native Business for training programs.

English as a second language programs and a pre-apprenticeship program were established to meet MTS's needs and those of target groups. More consistent employee performance evaluations have also been instituted. Provision of specialized equipment (such as operator equipment for the blind in Brandon) provides opportunities for employees with physical disabilities.

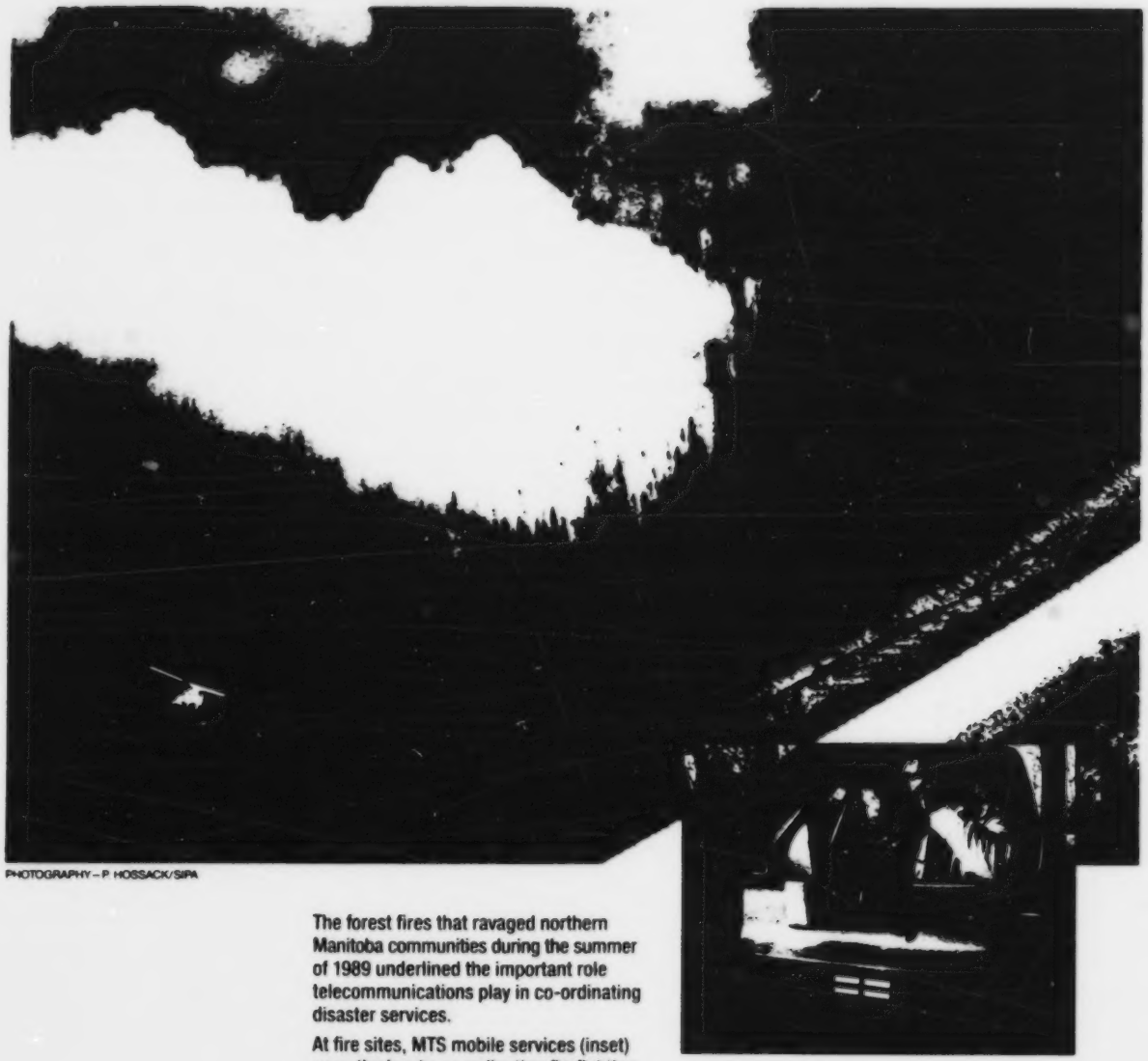
These Human Resources programs recognize the contributions of MTS's 5,462 employees throughout the province during 1989.

MTS recognizes its responsibility for reducing and preventing waste. In 1989, 130 tons of obsolete MTS records, primarily computer printouts, were sent to the Provincial Government Records Centre to be shredded, compacted and baled and then used for recycling.



In 1989, members of Chapter 50 of The Telephone Pioneers of America and their spouses, made and distributed almost 2,000 Hug-a-Bears to comfort children in distress.

Telephone Pioneers are active and retired telecommunications industry people who volunteer their time and technical skills in a variety of public service projects.



PHOTOGRAPHY – P. HOSSACK/SIPA

The forest fires that ravaged northern Manitoba communities during the summer of 1989 underlined the important role telecommunications play in co-ordinating disaster services.

At fire sites, MTS mobile services (inset) were the key to co-ordinating firefighting efforts. At the same time, MTS Northern Region staff and their colleagues in Winnipeg provided equipment and services to help provincial officials coordinate the massive evacuation of people from fire-threatened communities.

FINANCIAL STATEMENTS

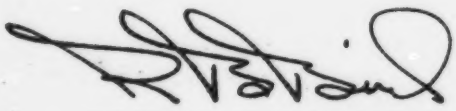
Management's Report

The integrity and objectivity of the financial statements and accompanying notes in the annual report are the responsibility of management.

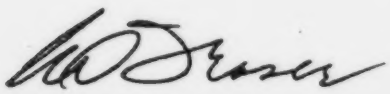
To fulfill this responsibility, The Manitoba Telephone System maintains internal control systems to provide reasonable assurance that the books and records, from which the financial statements are derived, accurately reflect all transactions and that established policies and procedures are followed. The internal control systems are supported by regular reviews by internal auditors and by examination of the financial statements by Touche Ross & Co., independent chartered accountants.

The responsibility of the Board of Commissioners for the statements is pursued principally through its Audit Committee, which meets periodically with management and the internal and external auditors, to review accounting principles and practices.

The external auditors have full access to the Audit Committee both with and without management present. Their report, which provides an independent review of the system of internal controls and the compliance of the statements to generally accepted accounting principles, follows.



PRESIDENT AND CHIEF EXECUTIVE OFFICER



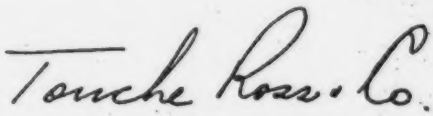
VICE-PRESIDENT, FINANCE

Auditors' Report

To the Board of Commissioners,
The Manitoba Telephone System

We have examined the balance sheet of The Manitoba Telephone System as at December 31, 1989 and the statements of operations and reinvested earnings and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these financial statements present fairly the financial position of the company as at December 31, 1989 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles applied, except for changes made in the method of accounting for depreciation and pensions as described in Note 2 to the financial statements, on a basis consistent with that of the preceding year.



CHARTERED ACCOUNTANTS

Winnipeg, Manitoba
March 16, 1990

BALANCE SHEET

AS AT DECEMBER 31, 1989

Assets	1989	1988
	(in Thousands of Dollars)	
TELECOMMUNICATIONS PROPERTY		
Buildings, plant and equipment	$1,533,625	$1,445,008
Less accumulated depreciation	743,809	688,368
	789,816	756,640
Land	6,509	6,025
Plant under construction	34,269	35,320
Materials and supplies, at cost	18,961	17,166
	849,555	815,151
INVESTMENTS (Note 3)	1,561	999
INVESTMENTS HELD FOR PENSION OBLIGATIONS (Note 8 (b))	137,724	100,302
CURRENT ASSETS		
Short term investments	32,000	46,200
Accounts receivable	60,179	53,422
Prepayments	8,476	7,842
	100,655	107,464
DEFERRED CHARGES		
Unrealized foreign currency losses, net of amortization	129	5,094
Unamortized long-term debt costs	2,676	3,716
Preliminary engineering and miscellaneous	3,471	1,870
Deferred employee benefit costs, net of amortization	—	1,350
	6,276	12,030
	$1,095,771	$1,035,946

APPROVED ON BEHALF OF THE BOARD

CHAIRMAN

COMMISSIONER

See accompanying notes to financial statements.

Liabilities and Reinvested Earnings	1989	1988
	(in Thousands of Dollars)	
LONG-TERM DEBT (Note 9)	$ 771,197	$ 776,946
Less sinking fund investments	75,075	64,449
	696,122	712,497
DEFERRED EMPLOYEE BENEFITS (Note 4)	156,593	116,918
CURRENT LIABILITIES		
Outstanding cheques less cash in bank	33,495	36,068
Note payable	5,000	5,000
Accounts payable and accrued liabilities	52,378	49,798
Advance billings and payments	5,401	5,277
Accrued interest	23,783	23,033
	120,057	119,176
TOTAL LIABILITIES	972,772	948,591
REINVESTED EARNINGS	122,999	87,355
	$1,095,771	$1,035,946

See accompanying notes to financial statements.

STATEMENT OF OPERATIONS AND REINVESTED EARNINGS

FOR THE YEAR ENDED DECEMBER 31, 1989

	1989	1988
	(in Thousands of Dollars)	
OPERATING REVENUES		
Long distance service	$ 294,453	$ 253,741
Local service	181,534	166,049
Miscellaneous	40,577	34,775
	516,564	454,565
OPERATING EXPENSES		
Operations and administration	211,135	188,268
General	69,999	61,576
Depreciation	135,181	118,635
Operating taxes (Note 5)	12,489	12,294
	428,804	380,773
NET EARNINGS FROM OPERATIONS	87,760	73,792
OTHER REVENUES (Note 6)	22,702	19,269
NET EARNINGS BEFORE DEBT CHARGES	110,462	93,061
DEBT CHARGES (Note 7)	74,818	77,616
NET EARNINGS FOR THE YEAR	35,644	15,445
REINVESTED EARNINGS, AT BEGINNING OF YEAR	87,355	71,910
REINVESTED EARNINGS, AT END OF YEAR	$122,999	$ 87,355

See accompanying notes to financial statements.

STATEMENT OF CHANGES IN FINANCIAL POSITION

FOR THE YEAR ENDED DECEMBER 31, 1989

	1989	1988
	(in Thousands of Dollars)	
CASH PROVIDED BY (USED FOR) OPERATING ACTIVITIES		
From operations		
Net earnings for the year	$ 35,644	$ 15,445
Cash provided by (used for) changes in working capital	(3,937)	349
Add depreciation and other items not requiring cash (net)	170,508	150,618
Payments toward deferred employee benefits	(1,143)	(899)
Total cash provided by operating activities	201,072	165,513
CASH PROVIDED BY (USED FOR) FINANCIAL ACTIVITIES		
Issuance of long-term debt	—	22,000
Repayment of long-term debt	(118)	(25,000)
Sinking fund withdrawals	35	3,000
Contribution to sinking fund	(10,115)	(9,870)
Total cash used for financial activities	(10,198)	(9,870)
CASH USED FOR INVESTMENT ACTIVITIES		
Construction program expenditures (net)	(164,517)	(149,387)
Increase in investments held for pension obligations	(37,422)	(34,953)
Increase in investments	(562)	—
Total cash used for investment activities	(202,501)	(184,340)
DECREASE IN CASH	(11,627)	(28,697)
CASH, AT BEGINNING OF YEAR	10,132	38,829
CASH, AT END OF YEAR	$ (1,495)	$ 10,132

Cash represents cash and short term investments net of outstanding cheques.

See accompanying notes to financial statements.

NOTES TO FINANCIAL STATEMENTS

DECEMBER 31, 1989

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

a) General

The Manitoba Telephone System is incorporated by virtue of the provisions of The Manitoba Telephone Act, as a Crown Corporation of The Province of Manitoba.

The Manitoba Telephone System follows accounting practices similar to those used by other companies in the telecommunications industry.

b) Telecommunications property

Telecommunications property is recorded at original cost including materials, direct labour and overhead costs. In addition, telecommunications property includes the cost of funds used to finance the construction, based on the duration of the projects.

c) Depreciation

Depreciation is calculated on a straight-line basis over the estimated useful life of telecommunications property by applying rates which are based on a continuing program of engineering studies.

When depreciable telephone property is retired, the original cost of such property, adjusted by any disposal proceeds and costs of removal, is charged to accumulated depreciation.

d) Translation of foreign currencies

Foreign currencies have been translated into Canadian funds at rates of exchange on the following basis:

i. long-term debt at rates prevailing at year-end;
ii. accured interest at rates prevailing at year-end;
iii. debt charges at rates prevailing at the date of each transaction.

The unrealized gains and losses on long-term debt resulting from the policy of using rates prevailing at year-end is being amortized over the remaining term of the debt on a straight-line basis.

e) Amortization of bond premiums and discounts in sinking fund investments

Bond premiums and discounts arising from the purchase of bonds at other than face value are amortized over the remaining life of the bond.

f) Amortization of long-term debt costs

Costs associated with the issuance of long-term debt are being deferred and amortized over the term of the original issue.

2. CHANGE IN ACCOUNTING POLICIES

a) Depreciation

In 1989, The Manitoba Telephone System made adjustments to depreciation policies to bring its practices more in line with the telecommunications industry. The net book value of certain assets, consisting primarily of minor station equipment, tools and office equipment below a prescribed level has been written off to depreciation expense. The accounting change was applied on a prospective basis and resulted in an additional charge to depreciation expense in 1989 of approximately $20,400,000.

b) Pensions

During 1989, The Manitoba Telephone System changed the method of accounting for pension expense from recording an amount equal to the funding contribution approved by the Board of Commissioners to the accounting principles for pension costs and obligations as recommended by the Canadian Institute of Chartered Accountants.

The accounting change was applied on a prospective basis effective January 1, 1989.

3. INVESTMENTS

	1989	1988
	(in Thousands of Dollars)	
Long-term disability fund, at cost	$ 562	$ —
Telesat Canada, 99,900 common shares, at cost	999	999
	$ 1,561	$ 999

Effective September 2, 1989, The Manitoba Telephone System implemented a long term disability (LTD) plan. The Board of Commissioners also approved the establishment of a LTD Fund, to be reviewed annually by independent actuaries. The initial contribution to the Fund of $562,000 was made December 31, 1989. An actuarial provision of $698,000 was made as of December 31, 1989, to establish the liability for the LTD Plan.

4. DEFERRED EMPLOYEE BENEFITS

Obligation for pensions, vested sick leave and long term disability have been recorded on the balance sheet as follows:

	1989	1988
	(in Thousands of Dollars)	
Pensions (Note 8)	$137,724	$100,302
Vested sick leave	18,171	16,616
Long term disability	698	—
	$156,593	$116,918

5. OPERATING TAXES

Operating taxes represents grants to municipalities in lieu of property taxes, The Manitoba Telephone System's portion of Canada Pension Plan and Unemployment Insurance, the Health and Education Levy, Federal Telecommunications Service Tax and general levies.

6. OTHER REVENUES

	1989	1988
	(in Thousands of Dollars)	
Investment income	$ 18,312	$ 13,847
Surcharge on overdue accounts	2,465	2,310
Interest charged to construction	610	1,338
Miscellaneous, net	1,315	1,774
	$ 22,702	$ 19,269

7. DEBT CHARGES

	1989	1988
	(in Thousands of Dollars)	
Interest on long-term debt	$ 73,407	$ 74,306
Amortization (recovery) of unrealized foreign currency losses	(655)	1,508
Amortization of long-term debt costs	1,040	797
Other interest expense and debt charges	1,026	1,005
	$ 74,818	$ 77,616

8. PENSIONS

a) Pension plan

Employees of The Manitoba Telephone System are pensionable under the Civil Service Superannuation Fund (the Fund) and make contributions to the Fund at prescribed rates. The Fund maintains a defined benefit final average pension plan which covers substantially all of The Manitoba Telephone System's employees. The plan provides pensions based on length of service and final average earnings.

b) Investments held for pension obligations

Investments held for pension obligations are recorded at cost. The market value of investments at December 31, 1989 totalled $143,061,000 (December 31, 1988 — $98,166,000). The investments are administered by external investment managers.

c) Pension liability

Based on a formula contained in an actuarial report prepared as of December 31, 1986, The Manitoba Telephone System had a liability for pension obligations as at December 31, 1989 of approximately $260,000,000 (December 31, 1988 — $232,000,000). This liability is based on the assumption that future pensions will be increased due to increases in the cost of living.

9. LONG-TERM DEBT

a) Advances, note and bonds payable

	1989	1988
	(in Thousands of Dollars)	
Province of Manitoba advances		
*Series BG, 9.375%, due August 2, 1990	$100,000	$100,000
Series 11E, 14¾%, due July 1, 1991 ($40.0 million U.S.)	46,311	47,708
Series 11J, 15¼%, due March 31, 1992	40,000	40,000
Series AN, 11½%, due May 15, 1995	50,000	50,000
Series UFA1, 11%, due November 5, 1995	55,000	55,000
Series AX, 7.87%, due May 20, 1996	64,092	64,092
Series UFA2, 9 13/25%, due September 26, 1996	65,600	65,600
**Series BC, 8½%, due February 5, 1997	87,500	87,500
Series 10T, 9¾%, due May 15, 1998	12,090	12,090
Series 11A, 10¼%, due August 1, 1999	5,000	5,000
Series 9X, 10%, due December 5, 1999	10,000	10,000
	535,593	536,990
Note payable		
Province of Manitoba note, 12.05%, due February 16, 1990	22,000	22,000
The Manitoba Telephone System bonds payable		
Debentures fully guaranteed by the Province of Manitoba		
Series 1J, 7¾%, due February 15, 1989	—	10
Series 1M, 8%, due September 15, 1989	—	108
Series 1E, 5%, due January 15, 1991 ($14.5 million U.S.)	16,788	17,294
Series 1N, 7⅞%, due November 15, 1991	20,000	20,000
Series 1F, 6¼%, due December 1, 1991	20,000	20,000
***Series 1V, 8.65%, due January 3, 1992	59,816	63,544
Series 1G, 7%, due February 15, 1993	20,000	20,000
Series 1P, 7⅞%, due March 15, 1993	10,000	10,000
Series 1T, 10%, due July 2, 1995	10,000	10,000
Series 1U, 10½%, due May 1, 1996	20,000	20,000
Series 1S, 8¾%, due March 1, 1999	37,000	37,000
	213,604	217,956
	$771,197	$776,946

* After 1990, extendable at the option of the bond holder
** Retractable February 5, 1990
*** Converted to Canadian dollars in 1989

9. LONG-TERM DEBT (continued)

b) Sinking fund

Under the requirements of The Manitoba Telephone Act, The Manitoba Telephone System is required to pay a contribution to the Minister of Finance of the Province of Manitoba, as trustee for the Sinking Fund. The Sinking Fund contribution for the year ending December 31, 1989 was $10,115,000 (December 31, 1988-$9,870,000). The market value of the investments held in the fund at December 31, 1989 is $74,803,000 (December 31, 1988-$63,299,000).

The following payments will be required to meet sinking fund conditions and debt retirements:

Year ending	Sinking Fund Payment	Debt Maturities
	(in Thousands of Dollars)	
1990	$10,572	$205,796
1991	9,452	162,916
1992	6,808	40,000
1993	6,470	30,000
1994	5,954	—

c) Refinancing

It is the intention of The Manitoba Telephone System to refinance its maturing long-term debt, and accordingly all such debt is presented as a long-term obligation.

10. LEASE COMMITMENTS

The Manitoba Telephone System rents buildings and construction and other equipment under operating leases. The aggregate annual rental of the commitments under the leases, which expire at varying dates to December 31, 1994, are:

1990	$3,753,821
1991	2,396,152
1992	2,186,218
1993	1,649,298
1994	370,563

FIVE YEARS IN REVIEW

(NOT SUBJECT TO AUDITORS' REPORT)

	12 Months Ended December 31,		9 Months Ended December 31,	12 Months Ended March 31,	
STATEMENT OF OPERATIONS (Thousands of Dollars)	1989	1988	1987	1987	1986
Total operating revenues	$ 516,564	$ 454,565	$ 310,328	$ 379,319	$ 349,382
Total operating expenses	428,804	380,773	257,699	324,934	282,916
Other revenues	22,702	19,269	14,133	16,751	17,231
Debt charges	74,818	77,616	64,815	91,127	84,735
Extraordinary item	—	—	—	—	27,110
Net earnings (loss)	35,644	15,445	1,947	(19,991)	(28,148)
BALANCE SHEET (Thousands of Dollars)					
Telephone plant	$1,593,364	$1,503,519	$1,468,737	$1,379,826	$1,257,934
Accumulated depreciation	743,809	688,368	692,406	642,123	571,517
Investments and sinking funds	214,360	165,750	123,492	104,263	123,737
Long-term debt	771,197	776,946	804,055	753,325	690,151
Reinvested earnings	122,999	87,355	71,910	67,563	87,554
TELEPHONE STATISTICS					
Plant investment per main telephone	$ 2,972	$ 2,811	$ 2,774	$ 2,690	$ 2,504
Main telephones in service	536,214	534,819	529,408	512,984	502,286
Main telephones added during the period	1,395	5,411	16,424	10,698	14,846
Average daily local calls (in thousands)	5,976	5,779	5,482	5,342	4,910
Average daily long distance calls (in thousands)	319	288	266	251	235
OTHER STATISTICS					
Salaries and wages (in thousands of dollars)	$ 178,977	$ 160,284	$ 115,585	$ 146,978	$ 139,822
Number of employees	5,462	5,212	5,064	5,046	4,899
Employees per thousand main telephones	10.2	9.7	9.6	9.8	9.8
Long-term debt percentage of total invested capital	85.0	89.0	90.9	91.0	87.5
Debt charge coverage ratio	1.4	1.2	1.0	.8	.9
Gross construction expenditures (in thousands of dollars)	$ 174,056	$ 159,928	$ 132,776	$ 166,060	$ 153,154